No. 08-1134

MAY 2 2 2009

In The

Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY TO BRIEF IN OPPOSITION

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REASONS FOR GRANTING THE PETITION

I. Because the discharge exception of § 523(a)(8) is "self-executing" and requires the bankruptcy court to find undue hardship as a condition to discharging a student loan, USA Funds was entitled to rely upon the law, and cannot be deemed to have waived the bankruptcy court's non-compliance with it.

Espinosa cites no legal authority for his waiver argument, which instead depends upon mischaracterizing the facts and turning bankruptcy law and procedure on its head.

The first premise of Espinosa's argument is the false assertion that his plan "propos[ed] that the hardship hearing be waived." (Brief in Opp. at 6.) The plan said no such thing. In fact, the plan said nothing about undue hardship, an adversary proceeding, or the waiver of either. (E.R. 3.) If Espinosa is suggesting (*see* Brief in Opp. at 6) that the Ninth Circuit characterized the plan as a proposal to waive the requirement of an adversary proceeding and a determination of undue hardship, it could not and did not. Instead, as that court stated, "Espinosa simply listed the student debt in his Chapter 13 plan." (App. 7.)

Espinosa's second premise is that USA Funds knew the details of his Chapter 13 plan and failed to take affirmative action to "claim its right to . . . an adversary proceeding." (Brief in Opp. at 5.) However, as this Court recognized in *Tennessee Student*

Assistance Corp. v. Hood, the § 523(a)(8) exception of student loan debt from discharge is "self-executing" and "[u]nless the *debtor* affirmatively secures a hardship determination, the discharge order will not include a student loan debt." 541 U.S. at 450 (emphasis added). "The current Bankruptcy Rules require the debtor to file an 'adversary proceeding' against the State in order to discharge his student loan debt." *Id.* at 451. Thus, the burden is not on the creditor to commence an adversary proceeding and seek a determination of dischargeability.

That a creditor may therefore disregard a plan provision to discharge a student loan without waiving the legal requirement to first find undue hardship is supported by *Hood*, which recognized that a creditor can ignore an adversary proceeding summons without waiving the court's independent duty to find undue hardship: "Hood concedes that even if TSAC ignores the summons and chooses not to participate in the proceeding the Bankruptcy Court cannot discharge her debt without making an undue hardship determination." *Id.* at 453-54.

Consequently, it follows that a creditor, like USA Funds, can also ignore a mere discharge declaration in a plan without waiving the requisite undue hardship finding. As could the creditor in the above-quoted hypothetical in *Hood*, USA Funds was entitled by law to expect that the bankruptcy court would not discharge a student loan without first finding undue hardship as mandated by § 523(a)(8). *Educational Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*),

505 F.3d 1033, 1049 (10th Cir. 2007); *Banks v. Sallie Mae Servicing Corp. (In re Banks),* 299 F.3d 296, 302 (4th Cir. 2002). *See also City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293, 297 (1953) ("[E]ven creditors who have knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred.").

Espinosa's waiver argument was therefore rejected in one of the many cases in conflict with the Ninth Circuit:

> Hanson criticizes ECMC for sitting on its rights and failing to timely challenge the discharge order. However, student loan creditors justifiably rely on the explicit notice provisions of the Bankruptcy Code and Rules and have no reason to act until the service of a summons for an adversary proceeding apprises them that their property rights may be affected. As noted by the Supreme Court in *Mullane*, due process requires "notice and the opportunity for hearing appropriate to the nature of the case" prior to deprivation of property rights, and the creditor in this case was denied the pre-deprivation notice and hearing that are required in bankruptcies involving student loans. *Mullane*, 339 U.S. at 313, 70 S. Ct. 652.

In re Hanson, 397 F.3d 482, 486-87 (7th Cir. 2005).

II. A creditor's knowledge of a plan proposing to discharge student loan debt is not dispositive, and due process is denied, when the court orders a discharge without finding undue hardship as required by statute.

Espinosa ignores the teaching of *City of New York v. New York, New Haven & Hartford R.R.*, *supra*, that even a creditor who has actual knowledge of a bankruptcy proceeding is entitled to notice in the manner specified by law. In that case, the City had improvement liens on the debtor railroad's real estate. Pursuant to statute, the court issued an order giving creditors a deadline to file claims. Although the Bankruptcy Act provided that "[t]he judge shall require [debtors] to file in the court a list of all known creditors," that was not done. The Act further provided that "[t]he judge shall cause reasonable notice of the period in which claims may be filed, . . . by publication or otherwise." The court required the railroad to give notice by mail to specific creditors and all others who had appeared in court, and to publish the notice. Although the City's liens were known to the railroad, the City did not receive notice by mail. The City did not file a claim, and therefore the court ruled the City's liens were unenforceable.

This Court rejected the argument that the City's knowledge of the bankruptcy proceeding trumped the requirement to give notice as required by law, stating:

> Had the judge complied with the statute's mandate, it is likely that notice would have been mailed to New York City . . . .
>
> [E]ven creditors who have knowledge of a reorganization have a right to assume that the statutory "reasonable notice" will be given them before their claims are forever barred. When the judge ordered notice by mail to be given the appearing creditors, New York City acted reasonably in waiting to receive the same treatment.
>
> The statutory command for notice embodies a basic principal of justice – that a reasonable opportunity to be heard must precede judicial denial of a party's claimed rights . . . .

344 U.S. at 296-97.

Likewise here, any knowledge of the plan provision for discharge by declaration of Espinosa's student loan debt is not dispositive. USA Funds acted reasonably in waiting for notice in the form of a summons and complaint in an adversary proceeding to determine undue hardship, as required by the statute and Bankruptcy Rules. Had the bankruptcy court complied with the mandate of the statute to adjudicate the hardship issue, USA Funds would have received proper notice and would not have been denied due process. The failure to adjudicate an issue made mandatory by statute is a denial of due process. *Great American Trading Corp. v. I.C.P. Cocoa, Inc.*, 629 F.2d 1282 (7th Cir. 1980) (judgment confirming arbitration award entered without trying issue of

existence of agreement to arbitrate, as required by statute, before compelling arbitration was void).

Finally, contrary to Espinosa's assertions, the cases that conflict with the Ninth Circuit's decision are not distinguishable on the ground that the creditors were unaware of the proposed discharge of student loan debt. In all but one of the cases, the creditor received the plan proposing the discharge. *In re Banks*, *supra* at 299; *Ruehle v. Educational Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679, 681 (6th Cir. 2005); *Whelton v. Educational Credit Mgmt. Corp.*, 432 F.3d 150, 152 (2d Cir. 2005); *In re Mersmann*, *supra* at 1039, 1041. In *In re Hanson*, the creditor received the petition listing only the debtor's student loan debt and, presumably, at least a summary of the plan that proposed to pay only 19% of the debt. *Supra* at 483.

III. When *Hood* is portrayed accurately, the Ninth Circuit's decision conflicts.

Espinosa attempts to avoid the fact that the result reached by the Ninth Circuit conflicts with the principles recognized in *Tennessee Student Assistance Corp. v. Hood* by misstating its holding and misapplying its language. This Court held in *Hood* that "the undue hardship determination sought . . . in this case is not a suit against a State for purposes of the Eleventh Amendment." 541 U.S. at 451. *Hood* did not hold, as Espinosa asserts, that "the acceptable form of notice for a proceeding to discharge a debt is not

limited to the issuance of a summons in an adversary proceeding" and "failure to use the adversary proceeding is not a constitutional violation." (Brief in Opp. at 11.)

Neither did *Hood* hold, as Espinosa also asserts, that "a bankruptcy court determination of dischargeability was (sic) an *in rem* proceeding." (Brief in Opp. at 12.) That "the discharge of a debt by a bankruptcy court is . . . an *in rem* proceeding" was announced by this Court long, long ago. *Hood*, 541 U.S. at 447 (citing cases dating to 1876). That well established rule was instead the rationale for *Hood's* holding that an adversary proceeding to discharge a student loan is not a suit against the state.

To merely underscore the fact that the issuance of a summons to the state did not transform the *in rem* proceeding to one *in personam*, *Hood* observed that, but for Bankruptcy Rule 7001(6), a debtor could seek a discharge by motion:

> The text of § 523(a)(8) does not require a summons, and absent Rule 7001(6) a debtor could proceed by motion, . . . which would raise no constitutional concern.

541 U.S. at 453.

Contrary to Espinosa's argument, *Hood* did not approve the use of a motion or any procedure other than an adversary proceeding to seek the discharge of a student loan. (Neither does Judge Lundin's treatise.) "[T]he *Hood* Court's suggestion, in an

entirely different context, that a debtor could proceed by motion in the absence of the Bankruptcy Rules does not authorize debtors to ignore the requirements of the Rules." *In re Hanson*, 397 F.3d at 487. Therefore, *Hood* does not permit a debtor to seek discharge of a student loan by merely including a provision to that end in a proposed Chapter 13 plan.

IV. Espinosa makes the case for granting certiorari.

Espinosa's arguments demonstrate that certiorari should be granted. Espinosa contends, repeatedly, that a reversal of the Ninth Circuit's decision would "encroach" upon the finality of discharge orders, thus "generating" litigation and "disrupting bankruptcy administration" and causing other "broad ramifications." (Brief in Opp. at 20-33.)

Yet, even without reversing the Ninth Circuit, the situation that concerns Espinosa already exists elsewhere. By virtue of the conflicting cases, what is final in the Ninth Circuit is not final in the Second, Fourth, Sixth, Seventh and Tenth Circuits. Therefore, the consequences that Espinosa fears are already possible outside the Ninth Circuit.

In short, at present the law is not nationally uniform. The only way to make it so is to grant certiorari and resolve the conflict among the circuits.

Although Espinosa argues that it is unnecessary for this Court to intervene, his argument actually

underscores the need by again noting the conflict between the Ninth and other circuits: "Some of the cases involving the discharge of student loans by a debtor proposing waiver of a hardship hearing are critical of this aspect of Chapter 13 practice. Others, including the opinion below, are not." (Brief in Opp. at 29.)

The solution to this important issue of bankruptcy practice does not lie with Congress, as Espinosa suggests. Congress has already made it abundantly clear that student loans are not dischargeable absent proof of undue hardship. It is, instead, up to the courts to apply that mandate uniformly.

However, as Espinosa notes, the courts disagree on what is proper practice. (*Id.*) Therefore, that the bankruptcy courts have tools for dealing with improper practice does not alter the fact that what is proper in the Ninth Circuit is improper in five other circuits.

Neither is the solution, as Espinosa suggests, to leave the parties in each case to their own devices. Instead of the various forms of discharge by declaration illustrated by the cases (now euphemistically recharacterized after the fact by Espinosa as a "proposal for waiver"), a proper and uniform procedure already exists in the Rules. Namely, the debtor commences an adversary proceeding and gives proper notice to the creditor, who then decides, based upon

the usual legal and business considerations, whether or not to contest.

Respectfully submitted,

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